

Challenges Facing National Regulators in the Transition Period

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The presentation deals with the main challenges of a special transition period between the traditional monopolistic intensive development period and the period of getting a fully liberal telecommunications market. In this transition period the major challenges are created by the fact, that the traditional legal framework is too tight for the market development. Therefore the market and customers need lot of regulatory decisions, supporting competition. But on the other hand there are still valid contracts between the government and the incumbents giving certain special rights, supporting the guaranteed payback of their investments. Another important issue is the step-by-step preparation of the price structure, for a new, cost based regime. The third big challenge is the implementation of the new behaviour of the regulator itself.

The one decade long history of the NRA of Hungary, the Communications Authority (HIF) is very rich in events, in relation to the real success story of the Hungarian telecommunications development of the 90s. The 1st period (between 1990-1998) can be characterised by a very intensive, but mainly single-focused activity of all players (including concession-based operators and the regulator as well): to develop the basic infrastructure and meet all residential and business demand. This needed a very concentrated but somehow routine activity from the regulator: just to apply all legal tools to support the balanced development without any illegal technical or pricing steps of the players. It is very easy of course to say afterwards, that this was a simple period, but as we are well in the 2nd phase (1999-2001), we do meet now much more difficult challenges. This period is a transitional one between the mainly single-focused 1st period and the 3rd period, which can be characterised by a more and more developed really competitive liberal market.

This transitional phase can be described by a situation, when the legislation is inherited mainly from the 1st period (with some modifications), but the market and demand is closer to 3rd one.

In my short presentation I would like to list the major challenges we are meeting in this transitional period, and I try to describe very briefly our likely optimal answer to them. We know, of course, that the challenges, but much more the optimal answers are depending very much on the situation of a given country.

1. Questions, relating to the guaranteed pay-back of the huge investment in the basic infrastructure

In many of the developing countries and countries with emerging markets the lack of sufficient telecommunications creates a huge barrier in front of national economy's development and a political and social tension. Therefore, in order to solve this problem as soon as possible, governments used to contract with telecom companies and investors to build up the basic infrastructure for billions of USD-s. On the other side,

to limit the risk of investors, the contracts used to guarantee a certain period of exclusive service rights, at least for the basic telephony services. In Hungary this guaranteed exclusive period is eight years long, and expires at the end of 2001 for MATÁV (the big fully privatised national operator), and around the mid of 2002 for more than 10 smaller local operators, having local monopolies in about 20 per-cent of the territory of Hungary. The exclusive period and the relatively high prices gave a certainty to the investors to recover the majority of their investments.

However, six or seven years ago, the that time contracting parties did not foresee the huge technical and service development, resulting in a lot of competing services and networks. That time it was not obvious at all, that the mobile penetration will be so close to the fixed one and the IP based voice transmission services (with some quality compromise) can take away any traffic from long distance operators.

It was not foreseen at all, that the liberalisation will be linked with the unbundling of the local loop, and moreover, the partial unbundling for ADSL application is far not contradicting with the exclusive rights, defined purely for the local and long distance guaranteed quality telephone services.

It was not foreseen too, that there would be so many relatively strong service providers, trying to utilise every competition possibilities, being well prepared for immediate competition for the big telephone customers, on the first day of opening the market. And this means another growing risk for the incumbents.

In such circumstances the big lessons for the regulator are:

- How the emerging competition can be supported for the benefit of the customers and parallel to this, guarantee that the unforeseen market situation does not devalue the recent huge investment by the incumbents, having still exclusivity, but with much less value?
- How the trust in the government's commitments and in the stability of the regulation can be maintained, as the niches of the legal framework are growing and offering a lot of space for taking away parts of the guaranteed markets by unforeseen competition, beneficial for the market and the customers, but reducing the originally planned profit of the contracted investors?

In Hungary this situation can be handled only by a very **open and transparent regulatory behaviour, having continuous contacts with all parties**. We are today fully supported both by the government and the public in letting the competition emerge as far as we/or the market players do not violate the written text of the law. This is beneficial of course for the public and the so-called alternative operators, but acceptable also for the incumbents, as they can see clearly the limits of their own playing field, and the new playground is open also for them.

2. Price and interconnection regulation

During the monopolistic period (1st phase) the price regulation tries to balance to contradicting intentions: keep the prices as low as possible because of social reasons, and keep or rise the profit content of the prices, in order to make the investment more attractive. The two intentions used to be resulted in a combination of below-cost local and far-above-cost long distance and international tariffs, as the former is a more social, the latter are more business issues. If, beside the long distance operator, there are several local and mobile operators, the interconnection charges used to be used not only for sharing the revenues on real cost basis, but also for compensating the losses caused by less attractive areas. It means, that the interconnection regime has been used for a hidden financing of the universal service obligation.

It is a general experience, that without competition, the efficiency of the operators can be hardly improved by any regulatory measures. Therefore the price regulation can not be really effective from the customer's point of view.

In the 3rd phase the price regulation becomes a completely different role: it has to make sure, that the prices of a not yet perfectly competitive market shall be very close to the theoretical prices of a perfectly competitive one.

Either by this price regulation, or by a real competition, the result will be a real cost based system of prices. However, if the new price regulation were implemented in one step, it could result in huge problems, like:

- dramatically increasing local prices (in some cases by several hundred per-cent),
- bankrupting of the incumbent, caused by new competitors, taking away the long distance and international market by somewhat lower, but still profitable prices,
- the universal services would lack sufficient financial resources.

Therefore, in the 2nd, transitional period, one of the most important task of the regulator is to control and manage the tariff re-balancing and interconnection cost studies, in order to create a step by step process of getting cost based price structure instead of implementing one single shocking cost orientation step. This is really easy to recommend, but difficult to carry out. In practice, this needs a very professional preparation as well as good PR activity towards the politicians, the public and the operators. The timing is also very critical, as in case of a strong anti-inflation policy and/or under critical social circumstances, the unavoidable growth of the consumer basket's price is hardly acceptable by the government. It is important to note, however, that without these preparatory steps, the opening up of the market will be followed surely by a lot of disadvantageous side effects, like creaming off the market, unforeseen bankrupting, price-war without customer benefit, unserved areas etc.

3. Changing the behaviour of the regulator itself

As it was mentioned before, the 1st phase is relatively simple for the regulator: supporting infrastructure development, restricting the freedom of the market, supporting the exclusive rights of the incumbent, providing mainly technical surveillance of the market.

The 3rd phase will need a completely different regulator: to step back from a behaviour of restricting and permitting into an approach of letting, watching and intervening if necessary. Support the quick development of a really competitive market situation, by watching the happenings, and acting only, when a player violates the rules, specially, when a Dominant or SM (significant market) Player tries to use it's power to limit the competition. This new regulator needs a staff, thinking and reacting in a remarkable different way then before.

It is also an experience of the more developed countries, that only a well skilled, strong regulator can really control the market liberalisation. The traditional well-elaborated administrative routines are to be modified or abandoned. The new situation needs a lot of flexibility and business orientation, analytical approach. This requires very good economical and legal experts, beside the already existing technical ones. The salary level of them has to get close to the human market level of the operators. These changes can not be done in a short period. The 2nd transitional phase offers a very good chance to develop the new regulator, with all of the necessary skills, processes etc.

The challenges I tried to describe above are organic part of a fast growing telecom market, where the liberalisation is mainly not a political target, but a natural next step of the development. We feel day by day, that the present 5 to 8 years old legal framework is very tight for the market, and limits the development. Therefore it is very important, that the new legislation is under preparation, and about one year from now, we can enter into the 3rd phase of our telecom history. We can expect however, that this 3rd phase will not be less challenging than the present one. Therefore we are well in preparing ourselves to answer the new challenges.